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Order Instituting Rulemaking to Consider
Electric Procurement Policy Refinements
pursuant to the Joint Reliability Plan.

Rulemaking 14-02-001
(Filed February 5, 2014)

**THE OFFICE OF RATEPAYER ADVOCATES' COMMENTS
ON THE PRELIMINARY SCOPE OF THE JOINT RELIABILITY
PLAN PROCEEDING**

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I. INTRODUCTION

Pursuant to the Order Instituting Rulemaking (OIR) issued on February 13, 2014, the Office of Ratepayer Advocates (ORA) submits the following comments on the preliminary scoping memo for the Joint Reliability Plan (JRP) proceeding, (R.) 14-02-001. These comments address scope, schedule, need for hearings, and categorization.

ORA recommends consideration of additional issues for Tracks 1 and 3. For Track 1, the California Public Utilities Commission (CPUC) should address whether to increase the frequency of publication of aggregated Resource Adequacy (RA) capacity price data. Track 3 should include several policy questions related to the uncertainty and timing of issues surrounding the California Independent System Operator's (CAISO's) Capacity Procurement Mechanism (CPM) replacement proposal, which will be designed by CAISO in a stakeholder process before coming to the CPUC later this year.

The CPUC's consideration in Track 3 of whether to oppose or support the CAISO's CPM replacement proposal should be informed, at a minimum, by the resolution of two cases pending rehearing at FERC. Tracks 1 and 2 should continue as currently scheduled in the preliminary scoping memo. The final assigned Commissioner's scoping memo should not rule out the need for hearings prematurely because there are potential disputed issues of material fact in Tracks 1 and 3. Finally, Track 3 should be categorized as ratesetting rather than quasi-legislative.

II. ADDITIONAL ISSUES TO BE INCLUDED IN SCOPE

A. Track 1 – Multi-year resource adequacy (RA)

The following additional issues should be included in the scope of Track 1:

- 1. Should the CPUC increase the frequency of publication of aggregated RA capacity prices from annually to, for example, a semi-annual or quarterly basis in order to increase transparency for market participants? How can contract price data be sufficiently aggregated to ensure information cannot be used to engage in market manipulation to the detriment of ratepayers?**

Currently, RA obligation price transparency is limited to data available in the annual RA report. This report publishes aggregated price information to prevent market sellers from gleaning information that might be used to extract higher prices from load serving entities (LSEs) than are necessary to secure capacity obligations. Currently no pricing information is publicly available (to the marketplace in general) for years beyond the RA obligation years. There may be some benefit to making some of this data available at an aggregated level, to assist all market participants in understanding basic supply and demand information. This information can also support efforts to determine optimal levels of procurement of preferred resources. While such price transparency may

play a role in improving the efficiency of any multi-year RA procurement marketplace, such data release must not result in jeopardizing the ability of LSEs to procure capacity in a least-cost manner.

B. Track 3 - Commission policy positions and rules regarding CAISO's CPM replacement proposal

ORA commends the CPUC for including in scope many critical and interrelated questions regarding the economic and legal liability risks of establishing a market-based backstop procurement mechanism in California that is subject to exclusive FERC jurisdiction. The following additional issues regarding the economic and legal viability of the proposed backstop procurement mechanism should be included in the scope of Track 3:

1. Should the CPUC wait for final outcomes of relevant decisions currently pending rehearing and appeal before FERC and the federal courts before making a policy determination on whether it supports or opposes implementation of the proposed backstop procurement mechanism?

The timing of the CPUC's decision on whether to support a CAISO-developed backstop market mechanism is a critical issue for the JRP proceeding in light of several decisions casting uncertainty over the preemptive impact of organized markets. The CPUC recognizes the importance of these cases. For example, in an amicus brief recently filed in the United States Court of Appeals for the Third Circuit, the CPUC reiterated its concern regarding potential federal preemption of a "limited" backstop capacity auction, stating that the New Jersey U.S. District Court's decision, "if upheld on appeal, has the potential to negatively impact California's support for such a market."¹ Several significant decisions are currently pending rehearing and appeal before FERC and the federal courts.

For example, pending rehearing at FERC are decisions concerning the New England ISO (ISO-NE) and Midwest Independent Transmission System Operator, Inc. (MISO) that are particularly relevant to CPUC consideration of a CAISO-developed backstop market mechanism. FERC's determinations in these cases will inform Track 3 as to how FERC will seek to accommodate states' pursuit of legitimate policy objectives such as development of renewable resources while fulfilling its statutory obligation to ensure just and reasonable wholesale prices and grid reliability. The ISO-NE case is a good example of how FERC's concerns over getting wholesale prices and market design "right" may trump states' policy concerns over the types of resources to be procured.² ISO-NE administers a forward market for capacity (FCM), in which

¹ *PPL Energyplus, LLC, et al. v. Solomon*, Nos. 13,4330, 13-4394 & 13-4501 (consolidated) (3rd Cir.), (Appeal from Judgment of the U.S. District Court for the District of New Jersey, No. 3:11-cv-00745-PGS), Brief for the Connecticut Public Utilities Regulatory Authority *et al* as *Amici Curiae* in Support of Appellants, at 8.

² *NESCOE v. ISO-NE*, 142 FERC ¶ 61,108, Order Denying Complaint, rehearing granted, Apr. 15, 2013.

resources compete in an annual Forward Capacity Auction (FCA) to provide capacity on a three-year forward basis. Due to its concerns over mitigating buyer market power, FERC approved a request for a buyer-side floor mitigation mechanism (Minimum Offer Price Rule or MOPR) without granting an exemption for state sponsored renewable resources. State entities argued that unless FERC exempted renewable resources from the MOPR, state policy goals related to renewable resource development would be undermined.³ In denying the state entities' complaint, FERC found that "exempting renewables whose costs exceed the market price would result in the uneconomic entry of renewables and thereby reduce capacity prices."⁴ These issues are now before FERC on rehearing, where it is expected to again consider whether to exempt wind and solar resources from the MOPR, among other issues.

In the MISO case currently on rehearing, FERC had initially approved MISO's voluntary capacity auction, resulting from a stakeholder settlement agreement.⁵ Three years later, MISO unilaterally proposed a new Resource Adequacy Construct with a mandatory capacity auction for deficiencies. FERC denied this proposal, stating that MISO had not justified the need for a mandatory auction and that FERC did not consider the voluntary auction, which it had earlier approved, to be a precursor to a mandatory auction.⁶ However, in response to applications for rehearing alleging buyer market power, FERC agreed to reconsider whether a MOPR is necessary to mitigate buyer market power. FERC in its decision on rehearing may make major changes to MISO's resource adequacy construct. It may make the voluntary market mandatory by removing the opt-out provision, and add a MOPR to the forward capacity auction. Given the similarities between MISO and California resource adequacy paradigms, FERC's treatment of these issues on rehearing should inform assessments of the viability and durability of the market mechanism that CAISO designs. Moreover, the outcomes of the MISO and ISO-NE cases should influence the CPUC's determination of whether to support or oppose that market mechanism.

There is a timing problem regarding the uncertainty of these cases. It makes little sense for the CPUC to decide to support or oppose the market-based backstop mechanism that results from the CAISO stakeholder process, which may include a voluntary residual forward capacity auction,

³ *Id.*, p. 8.

⁴ *Id.*, p. 35.

⁵ In 2008, FERC accepted MISO's voluntary construct because "[t]he voluntary auction will afford LSEs with an additional mechanism to procure needed capacity and increase transparency in the procurement of capacity." Midwest Indep. Transmission Sys. Operator, Inc., 122 FERC ¶ 61,283 (March 2008 Order), rehearing denied, 125 FERC ¶ 61,061 (Oct. 20, 2008).

⁶ *In re MISO Order on Resource Adequacy Proposal*, 139 FERC ¶ 61,199 at p. 3.

when there is no clear idea of whether FERC will respect such a stakeholder consensus a few years later or instead decide to make participation in the auction mandatory. It would also be helpful to know whether FERC will require mitigation such as a MOPR later on, and if so, whether and under what circumstances it will exempt wind and solar resources from application of the rule. These issues are currently awaiting resolution by FERC in the MISO and ISO-NE cases. In the best case scenario, the final FERC disposition of these cases would be available to inform the design of the CAISO's market-based mechanism. The CPUC wisely reserved its right to oppose the backstop procurement mechanism as designed in the CAISO stakeholder process. Specifically, the JRP agreement emphasizes that "[t]he details of the proposed design will, however, be significant to any CPUC decisions to modify the existing reliability framework, including supporting or opposing the ultimate form of the backstop as it is designed by the ISO, and the CPUC expressly reserves the right to oppose an ISO filing seeking FERC authority to institute a Reliability Services Auction."⁷ The jurisdictional and economic impacts of the proposed backstop procurement mechanism are paramount concerns for the CPUC.

The scope of Track 3 should therefore include the threshold issues of whether the CPUC should wait for final outcomes of relevant decisions currently pending rehearing and appeal before FERC and the federal courts before making a policy determination on whether it supports or opposes implementation of the proposed backstop procurement mechanism⁸ and whether the CPUC's policy determination should follow disposition of particularly relevant cases, such as the NE-ISO and MISO cases discussed above.

2. Does the proposed market-based backstop mechanism contain sufficient design provisions to prevent it from becoming a *de facto* primary procurement market?

The JRP agreement states that

"the design of a market-based backstop procurement mechanism must fully accommodate resource procurement undertaken pursuant to CPUC decisions. Any CPM replacement mechanism should not inappropriately distort the prices or volume of bilaterally-negotiated capacity contracts or fail to fully recognize resources (preferred or new conventional) that have been procured as a result of or through state policy mandated programs. Any CPM replacement mechanism should also not be designed to be or become the primary forward capacity procurement mechanism for LSEs."⁹

⁷ JRP agreement, p. 10, November 8, 2013 (attached as Appendix A to the JRP OIR).

⁸ In addition to the MISO and NE-ISO rehearings pending at FERC and the Third Circuit appeal cited above, see *PPL Energy Plus, LLC v. Nazarian* No. 13-2419 (4th Cir.).

⁹ JRP agreement, p. 10, November 8, 2013 (attached as Appendix A to the JRP OIR).

If the CPUC determines that the proposed market-based backstop mechanism does not meet the requirements discussed above, it may either oppose the proposal or seek to include potential modifications.¹⁰ It is not certain that the CAISO stakeholder process or Straw Proposal for a backstop procurement mechanism will acknowledge these economic viability concerns or address them with specific recommendations and design features for risk mitigation. ORA recommends that the scope of Track 3 include consideration of market design provisions that would prevent or minimize the risk of having the backstop market become the primary procurement market.

The CPUC may need to consider additional issues depending upon the final version of the backstop developed by CAISO.

3. Are there feasible mechanisms to reverse the unintended outcome of a CAISO backstop procurement mechanism becoming a *de facto* primary procurement market?

The JRP OIR includes the following issue: “How should a proposed tariff amendment for a market-based backstop procurement mechanism be structured in order to prevent material design modifications or rule changes in the future, either by FERC or in response to legal challenges initiated by third parties?”¹¹ The CPUC should expand the scope of Track 3 to explicitly include the related but distinct issue of whether a tariff provision or other form of protection can be created to effectively act as a “poison pill” if the proposed backstop procurement mechanism becomes a primary procurement market or a market that fails to fully recognize resources (preferred or new conventional) that have been procured to comply with state energy and environmental policies.

4. Should the CPUC seek a declaratory order from FERC on issues regarding the economic and legal viability of the CAISO proposal for a market-based backstop procurement mechanism, including whether the market can be kept residual?

ORA recommends that the CPUC specifically scope the issue of whether a petition for declaratory order could be filed with FERC that could help the CPUC determine under what conditions and design the CAISO’s proposed market-based backstop mechanism can be kept residual. As discussed above, claims in other areas of the country with organized markets that have caused FERC to change the rules for residual voluntary auctions (developed by stakeholder settlement) in a manner that impinges on state authority over resource adequacy and on state policy preferences for certain resources.

¹⁰ JRP OIR, p. 13 (“We expect this process to ultimately result in a Commission policy determination on whether it supports or opposes implementation of the proposed backstop procurement mechanism, including any potential modifications the Commission would endorse.” (emphasis added)).

¹¹ *Id.*, p. 15.

5. If the CPUC opposes implementation of the proposed backstop mechanism, should the CPUC instead support the extension of the current CAISO CPM tariff beyond its current date of expiration, without any changes?

CAISO's proposal for a new backstop mechanism is driven by the fact that the current CPM is set to expire in February 2016. ORA agrees that CAISO should extend its backstop authority beyond 2016, but is not convinced that CAISO's proposal for a market-based backstop mechanism will be the best solution for California. The CPUC should consider other alternatives to replace the expiring CPM. One of those alternatives should include CPUC support for the extension of the current CAISO CPM beyond 2016.

III. SCHEDULE AND PRIORITIZATION OF ISSUES

ORA recommends that the CPUC wait for the outcomes of relevant decisions currently pending rehearing and appeal before FERC and the federal courts, as discussed above, before making its policy determination on whether it supports or opposes implementation of the CAISO-proposed backstop procurement mechanism. These decisions should impact the CPUC's policy determination on whether to support or oppose the implementation of the proposed backstop procurement mechanism. In the meantime, the CPUC should proceed with Tracks 1 and 2. The JRP OIR states that the CPUC "will not revisit our decision rejecting a centralized capacity market in this proceeding" and "will consider alternative proposals...such as supporting a limited form of an organized capacity auction to fulfill CAISO backstop procurement."¹² However, ORA is concerned that any form of a CAISO organized capacity auction, once established and subject to FERC jurisdiction, may not remain limited or residual and may become the *de facto* centralized capacity market that the CPUC rejected in 2010.¹³

ORA recommends that at a minimum the CPUC delay its policy determination until after FERC disposition of the two pending rehearings regarding ISO-NE and MISO. For reasons discussed above, both of these decisions on rehearing should inform the CPUC's assessment of the viability and durability of the market mechanism that CAISO designs, and will likely influence the CPUC's determination of whether to support or oppose that market mechanism.

Any delay in the CPUC's policy determination of whether to support the CAISO's proposal could require a joint request by CAISO and CPUC to extend the CPM past the current February 2016 expiration date, which is an option discussed above.

¹² *Id.*, p. 15.

¹³ See CPUC Decision (D.) 10-06-018.

IV. NEED FOR HEARINGS

ORA recommends that the assigned Commissioner's scoping memo not prematurely rule out the need for hearings because disputed issues of material fact may arise in Track 1 and Track 3.

A. Track 1 – Multi-year RA, may require evidentiary hearings

The following are examples of some of the data-driven issues identified in the JRP OIR preliminary scoping memo that are likely to involve disputed issues of material fact and may require evidentiary hearings to provide a meaningful forum to vet different parties' assumptions, data, and analysis:

- *Do reliability needs justify adopting forward resource adequacy obligations?*¹⁴ What are the currently-projected levels of flexible capacity in the system each year until 2022 or later years, and the full range of characteristics of those flexible resources?¹⁵ This assessment should include the flexibility contribution expected from resources procured or planned for procurement as a result of authorizations for local capacity in Track 1 and Track 4 of the 2012 LTPP (R.12-03-014). This should also include the ability of energy limited resources or other non-conventional resources to effectively contribute towards meeting flexibility requirements. Such non-conventional resources might ultimately be accounted for on either the “supply” or “demand” side of the ledger, but the quantity and attributes of these resources should be included in the assessment of any potential multi-year RA construct. Available CAISO and CPUC data may be either insufficient or has yet to be adequately vetted by stakeholders. What is the range of projected need for “effective flexible capacity” for each year through 2022 or later years?¹⁶ This need arises from the changing patterns of system net demand, in part due to increasing penetration of intermittent resources on the system. Continuing stochastic analysis of flexibility issues during the 2014 LTPP may essentially improve understanding of the range of ramping needs over the next decade, although thus far the LTPP analyses have focused on needs solely for later years (2020, 2022) and not the earlier years (2015 through 2017, e.g.) over which the RA procurement mechanism would apply.
- *Is three-years forward an appropriate time-frame for forward procurement requirements, or should there be a longer time horizon?*¹⁷ The time horizon for installation of flexibility resources

¹⁴ JRP OIR, p. 8.

¹⁵ This issue, regarding data through 2020, was raised by Sierra Club and The Utility Reform Network in their request for hearings in R.11-10-023, p. 2, filed March 7, 2013, available at: <http://docs.cpuc.ca.gov/PublishedDocs/Efile/G000/M058/K689/58689091.PDF>

¹⁶ *Id.*

¹⁷ JRP OIR, p. 9.

should be determined for all different forms of flexible resource, supply or demand-based. While conventional wisdom seems to indicate that California requires on the order of seven to nine years to install gas-fired generation, there is likely a range of time requirements for such installations depending on numerous factors. Non-conventional sources of flexible supply (or demand) may be available in shorter time frames than gas-fired generation. These types of data have yet to be fully vetted, and will have a significant impact on the results of any multi-year procurements, thus a full record may be required before arriving at the best time frames for forward procurement. Also, RA procurement time frames should complement LTPP procurement time frames.

- *What are the expected additional costs to implement new forward procurement requirements?*¹⁸

Currently, there are no estimates of the potential costs involved to structure and implement a multi-year RA procurement cycle. At a minimum, data is required on likely forward procurement costs based on i) the current stock of available resources, ii) current RA market costs, and iii) assumptions regarding available resources at points forward in time.

- *What percentage of resources should we require LSEs to procure two- or three- years ahead of the resource adequacy delivery years for each kind of capacity?*¹⁹ Numerous factors must be considered before designating any given obligation for any given forward year requirement, and there has yet to be a vetting of any of these types of data for California. How would the price of forward year procurement vary under different percentage obligation choices? Would there be material net impacts on customers depending on the level of forward obligation? What constitutes a “least cost” obligation percentage that will simultaneously ensure sufficient availability of different capacity needs to meet reliability needs? Data development is required to answer these questions.
- *Will the existence of forward capacity obligations be likely to have a positive or negative impact on the development of preferred resources in the state?*²⁰ Whether forward obligations impact preferred resource development depends in part on the determination of the ability of preferred resources to contribute to any given capacity need (local, system, or flexible). This determination is still in flux.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*, p. 10.

B. Track 3 - Commission policy positions and rules regarding CAISO's CPM replacement proposal may require evidentiary hearings

One of the issues identified in the scope of the JRP OIR scoping memo refers to examining “[w]hat are the likely costs to implement the proposed market-based backstop mechanism and the potential benefits for ratepayers? Are the costs justified in light of the expected benefits?”²¹ ORA agrees that it is necessary to examine how the potential change from the current CPM to a market-based backstop mechanism will impact ratepayer costs and benefits. This process should include a historical record on costs and quantities of backstop CPM capacity, projections of possible costs of backstop CPM under different frameworks, and consideration of how ratepayers should be protected from increasing costs under a market-based backstop mechanism. Evidentiary hearings may be required to provide a meaningful forum to vet different parties’ assumptions, data, and analysis that will ultimately have an impact on rates.

V. TRACK 3 SHOULD BE CATEGORIZED AS RATESETTING

Categorization of Track 3 should be changed from quasi-legislative to ratesetting. The language of the CPUC’s Rules of Practice and Procedure (CPUC Rules) and the CPUC’s application of those rules support a categorization of ratesetting. The determination that a proceeding is quasi-legislative pursuant to Rule 1.3(d) because it establishes “generic ratemaking policies or rules [] affecting a class of regulated entities”²² is not dispositive, but appears to depend on the extent of the rate impacts. For example, the CPUC’s renewable portfolio standard (RPS) rulemaking R.11-05-005, which implements RPS rules and policies for a number of respondents²³ is ratesetting. The CPUC explained that its determination to classify the proceeding as ratesetting:

“is based on the requirement to establish an RPS procurement cost limitation, and our ongoing implementation and administration of the RPS Program (as part of the larger procurement process) which *impacts respondent utilities’ rates*. This is consistent with our categorizations of the same or similar work in R.04-04-026, R.06-02-012, R.06-05-027, and R.08-08-009.”²⁴

The CPUC’s greenhouse gas (GHG) rulemaking considers cost and revenue issues associated with GHG emissions for a class of regulated entities.²⁵ The CPUC’s ongoing resource adequacy (RA)

²¹ *Id.*, p. 15.

²² Rule 1.3(c)(e) Commission Rules of Practice and Procedure.

²³ Order Instituting Rulemaking Regarding Implementation and Administration of the Renewables Portfolio Standard Program, R.11-05-005, May 11, 2005 (RPS OIR), Ordering Paragraph 12, p. 24. (“Respondents are all electrical corporations subject to Public Utilities Code Sections 399.11 et seq., all currently registered electric service providers and all current community choice aggregators.”)

²⁴ *Id.*, p. 14 (emphasis added).

²⁵ Order Instituting Rulemaking to Address Utility Cost and Revenue Issues Associated with Greenhouse Gas Emissions, R.11-03-012, March 24, 2011, Ordering Paragraph (OP) 4, p. 27.

proceeding ensures the availability of reliable and cost-effective electricity for load-serving entities subject to section 380 of the Public Utilities Code.²⁶ Both proceedings have significant potential impacts on rates. Both are ratesetting proceedings. In addition, CPUC Rule 7.1(e) emphasizes the CPUC's broad discretion in categorization, stating that ratesetting is the appropriate default category when a proceeding does not fit neatly into one of the categories.²⁷

Here, there are important ratepayer implications involved in the examination of how a market-based backstop mechanism, particularly one which considers adding 'insufficient flexible in annual or monthly resource plans' and 'insufficient multi-year forward capacity' to the existing CPM backstop events, will impact ratepayer costs and benefits.²⁸ Given that the CPM expenses under the status quo have been relatively small, it is necessary to examine how these expenses are likely to change, and how ratepayers should be protected from increasing costs under a market-based backstop mechanism. There are significant economic and legal risks of establishing a market-based backstop procurement mechanism in California that is subject to exclusive FERC jurisdiction. If the backstop mechanism were to become the *de facto* primary procurement market, or a mandatory market in which state-mandated preferred resources fail to clear the market, the potential costs to ratepayers would be enormous. Given the potential for significant ratepayer impacts, classifying Track 3 as ratesetting is appropriate under the CPUC's historical application of the categorization definition rules. In light of the uncertainty regarding the magnitude of potential ratepayer costs and benefits of a proposed backstop market, ratesetting is the appropriate default categorization pursuant to CPUC Rule 7.1(e)(2). Finally, Track 3's consideration of a new backstop mechanism should be categorized as ratesetting in order to promote transparency and fairness through application the CPUC's *ex parte* rules and reporting requirements.²⁹

²⁶ Order Instituting Rulemaking to Oversee the Resource Adequacy Program, Consider Program Refinements, and Establish Annual Local Procurement Obligations, October 27, 2011, OPs 1, 3, 5 at pp. 11-12.

²⁷ CPUC Rule 7.1(e)(1) ("When a proceeding may fit more than one category [adjudicatory, quasi-legislative, and ratesetting], the Commission may determine which category appears most suitable to the proceeding...."; Rule 7.1(e)(2) ("When a proceeding does not clearly fit into any of the categories [adjudicatory, quasi-legislative, and ratesetting], the proceeding will be conducted under the rules applicable to the ratesetting category....").

²⁸ JRP OIR, p. 15 acknowledges these ratepayer implications and includes the following as within scope of Track 3: "What are the likely costs to implement the proposed market-based backstop mechanism and the potential benefits for ratepayers? Are the costs justified in light of the expected benefits?"

²⁹ CPUC Rules 8.3(a) and 8.3(c) specify that *ex parte* communications are subject to reporting requirements (with restrictions) in any ratesetting proceeding, whereas *ex parte* communications in quasi-legislative proceedings are allowed without reporting restriction or reporting requirement.

Respectfully submitted,

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